

## Internal Revenue Service, Treasury

## § 1.643(a)-3

### § 1.643(a)-2 Deduction for personal exemption.

The deduction for personal exemption under section 642(b) is not allowed in the computation of distributable net income.

### § 1.643(a)-3 Capital gains and losses.

(a) Except as provided in § 1.643(a)-6, gains from the sale or exchange of capital assets are ordinarily excluded from distributable net income, and are not ordinarily considered as paid, credited, or required to be distributed to any beneficiary unless they are:

(1) Allocated to income under the terms of the governing instrument or local law by the fiduciary on its books or by notice to the beneficiary.

(2) Allocated to corpus and actually distributed to beneficiaries during the taxable year, or

(3) Utilized (pursuant to the terms of the governing instrument or the practice followed by the fiduciary) in determining the amount which is distributed or required to be distributed.

However, if capital gains are paid, permanently set aside, or to be used for the purposes specified in section 642(c), so that a charitable deduction is allowed under that section in respect of the gains, they must be included in the computation of distributable net income.

(b) Losses from the sale or exchange of capital assets are excluded in computing distributable net income except to the extent that they enter into the determination of any capital gains that are paid, credited, or required to be distributed to any beneficiary during the taxable year (but see § 1.642(h)-1 with respect to capital loss carryovers in the year of final termination of an estate or trust).

(c) The deduction under section 1202 (relating to capital gains) is taken into account in computing distributable net income to the extent that it is allocable to capital gains which are paid, permanently set aside, or to be used for the purposes specified in section 642(c). See the regulations under section 642(c) to determine the extent to which the amount so paid, permanently set aside, or to be used consists of capital gains. The deduction for capital gains provided in section 1202 insofar as it is al-

locable to the remainder of the capital gains is not taken into account.

(d) The application of this section may be illustrated by the following examples:

*Example 1.* A trust is created to pay the income to A for life, with a discretionary power in the trustee to invade principal for A's benefit. In the taxable year, \$10,000 is realized from the sale of securities at a profit, and \$10,000 in excess of income is distributed to A. The capital gain is not allocated to A by the trustee. During the taxable year the trustee received and paid out \$5,000 of dividends. No other cash was received or on hand during the taxable year. The capital gain will not ordinarily be included in distributable net income. However, if the trustee follows a regular practice of distributing the exact net proceeds of the sale of trust property, capital gains will be included in distributable net income.

*Example 2.* The result in example 1 would have been the same if the trustee had been directed to pay an annuity of \$15,000 a year to A (instead of being directed to pay the income to A with a discretionary power to distribute principal).

*Example 3.* The trustee of a trust containing Blackacre and other property is directed to hold Blackacre for ten years, and then sell it and distribute its proceeds to A. Any capital gain realized from the sale of Blackacre will be included in distributable net income.

*Example 4.* A trust instrument directs that the income shall be paid to A, and that the principal shall be distributed to A when he reaches age 35. All capital gains realized in the year of termination will be included in distributable net income. (See § 1.641(b)-3 for the determination of the year of final termination and the taxability of capital gains realized after the terminating event and before final distribution.)

*Example 5.* If in example 4 the trustee had been directed to distribute half of the principal to A when he reached 35, the capital gain would be included in distributable net income (and in the distribution to A) to the extent the capital gain is allocable to A under the governing instrument and local law. Thus, if the trust assets consisted entirely of 100 shares of corporation M stock and the trustee sold half the shares and distributed the proceeds to A, the entire capital gain would normally be considered as allocated to A. On the other hand, if the trustee sold all the shares and distributed half the proceeds to A, half the capital gain would be considered as allocable to A.

*Example 6.* If in example 4 the trustee had been directed to pay \$10,000 to B before making distribution to A, no portion of the capital gains would be allocable to B since the distribution to B is a gift of a specific sum of